H. ROSEN ENGINEERING B.V.

v.

SIOW YOON KEONG

HIGH COURT MALAYA, KUALA LUMPUR
K.L REKHRAJ JC
[CIVIL APPEAL NO. D-24-432-95]
16 NOVEMBER 1996

COMPANY LAW: *Directors - Director's responsibility for fraudulent trading - Section 304 Companies Act 1965 - Director using company's funds to speculate in shares in his own name - Losses in trading passed to company - Whether director paying himself in preference to company's creditors - Whether committing fraud - Whether personally liable for company's debt.*

WORDS & PHRASES: *"Fraud" - Section 304(1) Companies Act 1965.*

The defendant was the managing director of and the owner of 199,999 shares out of 200,000 shares in Ventura Industries Sdn. Bhd. ('the company'). By an agreement dated 1 August 1989 the plaintiff appointed the company as its agent in Malaysia. Through the efforts of the company, the plaintiff was awarded a contract by Petronas Gas Sdn. Bhd. ('Petronas') on 24 Mach 1990 for RM1,128,00. Payment by Petronas was to be made solely to the company but the agreement between the plaintiff and the company provided that upon receipt of the monies the company would retain 20% thereof as its entitlement and remit the balance 80% to the plaintiff.

The company having received RM1,067,000 from Petronas paid the plaintiff only RM423,000 and failed to pay the balance due to the plaintiff.

In previous Court proceedings taken against him as director under O. 48 RHC 1980, under cross-examination on oath, the defendant admitted that a further sum of RM423,000 was then still due and owing to the plaintiff. When asked as to what had happened to the said sum he stated that "we lost the money".

The plaintiff took out the present proceedings seeking relief under s. 304(1) of the Companies Act 1965, *inter alia*, to make the defendant personally liable for the balance sum of RM392,479.81 due to the plaintiff. It was not disputed that the defendant had used the company's funds to invest on the stock exchange, and as a result of losses suffered therefrom, had not been able to discharge the debt to the plaintiff. The evidence also showed that, upon realising that he was about to incur losses, and to avert the losses from falling upon him personally, the defendant arranged for a company resolution to ratify all

his past acts of investments as being made on behalf of the company. The primary question that arose was whether, on the facts, a declaration under s. 304 Companies Act could properly be made by the Court.

Held:

[1] For the plaintiff to succeed it had to prove that the business of the company had been carried out by the defendant as its managing director with intent to defraud its creditors or for any fraudulent purpose.

[2] The company had sufficient liquid funds at the relevant time to discharge the debt owing to the plaintiff, but the defendant had used these funds to speculate on the stock exchange and then passed the resulting loss to the company whilst recovering for himself in full, his own funds used in that speculative activity.

[3] The term "fraud" has a distinctive meaning given in the Concise Oxford Dictionary – 9th Edition as "the use of false representation to gain an unjust advantage; a dishonest artifice or trick; a person not fulfilling what is expected of him/her". "Fraud and fraudulent purpose" connotes actual dishonesty involving, according to current notions, an unfair trading among commercial men, real moral blame in relation to the expected standard of an ordinary and honest people.

[4] The defendant's conduct in preferring himself in payment over the priority of trade debts by signing a cheque to himself constituted an intention to defraud; or at least a fraudulent preference – morally not acceptable by the commercial world – as it is a dishonest conduct. It is an act of misfeasance for one's own purpose or benefit and this Court will not lend its hand or support in the act of such dishonesty.

[Defendant ordered to personally pay the plaintiff the sum of RM392,479.81 together with interest and costs on a solicitor and client basis]

Cases referred to:
Re William C. Leitch Bros. Ltd. [1932] 2 Ch. ***(foll)***
Royal Brunei Airlines Sdn. Bhd. v. Tan Kok Ming Philip [1996] 2 CLJ ***(foll)***
Aberdeen Ry. Co. v. Blaikie Bros. [1854] 1 Macq. 461 ***(foll)***

Legislation referred to:
Companies Act 1965, s. 304(1)
Rules of the High Court 1980, O. 48

For the plaintiff - W.M. Chang; M/s. Raja Darryl & Loh
For the defendant - Ramesh Kanapathy; M/s. Cheang & Ariff

JUDGMENT

K.L Rekhraj JC:

The plaintiff's action is for several reliefs sought pursuant to 's. 304(1)' of the Companies Act 1965 which reads as follows:

> 304. **Responsibility for fraudulent trading**
>
> (1) If in the course of the winding up of a company or in any proceedings against a company it appears that any business of the company has been carried on with **intent to defraud** creditors of the company or creditors of any other person or for any **fraudulent purpose**, the Court on the application of the liquidator or any creditor or contributory of the company may if it thinks proper so to do declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court directs.

In order for the plaintiff to succeed, it must be proved that the business of Ventura Industries Sdn. Bhd. ('the company') has been carried on by the defendant as its Managing Director with intent to defraud its creditors or for any fraudulent purpose.

The issue is therefore whether the facts show such an intent to defraud or a fraudulent purpose.

The company had the intention of securing contracts with Petronas in respect of pipeline corrosion detection systems.

The company then came into contact with the plaintiff which is a foreign based company with it's registered address in the Netherlands with expertise in this field.

The plaintiff not having any prior business experience in Malaysia, by an agreement dated l August 1989 ('the agency agreement') appointed the company as it's agent in Malaysia. It was submitted that by virtue of the agency agreement, the company came to be in a position of trust and owed fiduciary duties to the plaintiff.

By a quotation dated 18 October 1989 the plaintiff submitted a quotation to the company for the services to be performed in respect of Petronas tender 840202/5/8/89.

Through the efforts of the company, the plaintiff was awarded a contract by Petronas Gas Sdn. Bhd. ('Petronas') by way of a letter of award dated 24 March 1990. It was stated in the letter of award at para. 2 that the letter

of award constituted a binding contract between the plaintiff and Petronas pending the execution of the formal agreement. It was never mentioned in the letter of award that the company would also be a party to the formal agreement.

At all material times it was the defendant who had personally negotiated the contract with Petronas and the payment terms of the Petronas Contract was made very favourable to the company in that cl. 18 thereof provided that 100 per cent of the payment amounting to a total of RM1,128,000 would be made solely to the company even though the plaintiff was entitled to 80 per cent or RM900,000 of such payment.

The plaintiff completed the works under the Petronas Contract and various progressive payments totalling RM1,067,100 was paid by Petronas to the company without disclosure by the defendant to the plaintiff.

The agreement between the plaintiff and the company ('the said agreement') provided that upon receipt of the proceeds of the Petronas Contract, the company would retain 20 per cent thereof which is its entitlement and **remit the balance of 80 per cent to the plaintiff;** in that the company was merely a conduit in respect of the plaintiff's entitlement in respect of the proceeds of the Petronas Contract.

In breach of the said agreement, the company having received RM1,067,100 from Petronas paid the plaintiff only a sum of RM423,000 and failed to pay the balance further sums. In the defendant's own words under cross examination on Oath in respect of the proceedings under Kuala Lumpur High Court Suit No. D3-22- 1033-91 taken against him as a Director under O. 48 of the Rules of the High Court 1980 wherein an officer of a corporation is required to attend Court to be orally examined and to produce thereat any books or documents that shall be relevant; admitted:

> The defendant received the sum of RM1,067,100 from Petronas. From this sum they paid RM423,000 to the plaintiff. The balance sum still with the defendant is RM635,100. Out of this sum of RM635,100 is the sum of **RM423,000 belonging to the plaintiff and should have been paid to the plaintiff**.
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> In an answer to a question posed by the Senior Assistant Registrar upon the defendant's Examination on Oath on 28 March 1994, as to what has happened to the Petronas' money received by the defendant, his reply was, "we lost the money". When asked how he lost it, he chose to remain silent and refused to answer.

Having admitted that the sum of RM423,000 out of the balance sum received from Petronas belonged to the plaintiff, the defendant as the Managing Director of the company ought to have paid off to the plaintiff, but instead proceeded

and used the plaintiff's monies to invest in the share market. Such investment totalling RM911,110 is reflected in the company's audited accounts as investments in 1991.

The resolution exhibited and dated the 30 June 1991 of the company shows that RM464,610 worth of shares were purchased towards the end of 1990 and RM446,500 in 1991.

At the point in time when the shares were bought or recorded in the accounts, the defendant very well knew that the company was making losses over the past two to three years as is exhibited in the accounts and was clearly insolvent.

Upon examining the audited accounts of Ventura Industries for the years ended 30 June 1991 and 30 June 1992, the following facts were discovered:

(1) The company is not shown to have received any advances from the director prior to 1 July 1990. On the contrary, the director is shown to be owing money amounting to RM83,762 to the company as at 30 June 1990 (see the item "amount due from Director" classified under current assets in the balance sheet at 30 June 1990).

(2) The company is not shown to have made any investments prior to l July 1990. The investments costing RM911,110 alleged to be made during the year ended 30 June 1991 appear to have been taken up in the company's books by simply debiting the investment account with the said sum and crediting corresponding sum to the director's account. Therefore there is no question of the director, the defendant herein, could have made any cash advances to the company during the year ended 30 June 1991. This conclusion is supported by the fact that the directors have by their post-act, passed a resolution on 30 June 1991 ratifying the investments made by the director in his own personal name in prior-years; as if they were made on behalf of the company.

(3) The Statement of Funds Flow from 30 June 1990 to 30 June 1991 as supplied by the defendant appears to be motivated. It shows that the director's advances totalling RM607,010 have been deposited into the company's bank account during the year ended 30 June 1991 and investments costing RM911,110 is shown to have been paid out from the account. This cannot be correct. These figures have been incorporated into the statement to reconcile the "amount owing to Director at RM523,248" as classified under current liabilities in the balance sheet at 30 June 1991. The said sum of RM523,248 is arrived at as follows:

Amount due from Director at 1.7.90	RM83,762
Less: Cash advances alleged to be made during the year ended 30.6.91	RM607,010
Amount due to Director at 30.6.91	RM523,248

(4) A detailed examination of the company's books of accounts and the bank books; and the underlying records (e.g. bank deposit slips, cheque counterfoils and bank statements) for the relevant year **would have revealed a different story** than that as depicted by the above Fund Flow Statement; **and the records when called for have been denied with a statement that they are lost or misplaced whilst moving office.** Records being important documents if not produced when required give strong adverse inferences under 114 G of the Evidence Act which reads:

> The Court may presume the existence of any fact which it thinks likely to have happened, regard being had to the common course of natural events, human conduct, and public and private business, in their relation to the facts of the particular case.

The Court may presume:

(a) - (f) xxx

(g) that evidence which could be and is not produced would if produced be unfavourable to the person who withholds it;

(h) that if a man refuses to answer a question which he is not compelled to answer by law, the answer if given would be unfavourable to him;

(5) Reviewing the company's financial position on 30 June 1990 and immediately thereafter, I noticed that the company was very liquid and could have paid the debts owing to the plaintiff as its only major creditor without any need of the Director's advances. For example, the company had a bank balance of RM464,223 as at 30 June 1990 and at that time the only other major creditor was the plaintiff to whom a sum of about RM400,000 was owed (included under "other creditors and accruals of RM455,800" in the balance sheet at 30 June 1990). The company delayed payment to the plaintiff until 3 August 1990. Although the company is shown to have

subsequently received further contracted sums from Petronas, of which a greater portion was due to the plaintiff, the company did not make adequate payments to the plaintiff to discharge their debt.

(6) From the audited accounts it is also clearly shown that **the Director had used the company's funds by investing in shares on the stock exchange under his own name,** instead of discharging the debt to the plaintiff. Having acquired the shares, partly using the company funds and partly his own, the Director then realised that he was about to incur a loss on his investments; and to avert that loss failing upon him personally, he arranged for a company resolution to ratify all his past acts of investments being made as a trustee for and on behalf of the company; and by that act legitimised the use of the company funds for his own speculative investments and recovered his personal losses in full from the company.

(7) The Statement of Funds for the year ended 30 June 1992, as supplied showed that proceeds from disposal of shares totalling RM614,280 have been deposited into the company's bank account and repayment of advances amounting to RM523,248 made to the Director. These entries are highly improbable/suspect. As the investments were registered in the Director's personal name, therefore any cheques on the disposal of such investments would have been made out payable into the name of the defendant Director and could not be banked into the company's bank account. The most probable position appears to be that the Director had issued his personal cheque to the company to cover the balance, that is the gross disposal price of the shares less his alleged advances, if any in the purchase of shares.

In conclusion, I would state that Ventura had sufficient liquid funds at the relevant time to discharge the debt owing to the plaintiff; but the Director used these funds to speculate on the stock exchange and then passed on the resulting loss to the company whilst recovering for himself in full, his own funds used in that speculative activity. As a result, the company had become insolvent.

The facts of this case justify a claim against the Director for breach of his duty to act *bona fide* in the best interests of the company. The claim is grounded on two grounds, namely:

(i) that he had used the company funds to purchase shares in his own name without first seeking prior approval from the company; the fact that he has arranged with the company subsequently to ratify his investments does not make his unauthorised use of the company funds in the first place proper; and

(ii) that he had repaid to himself, **an unsecured creditor**, his so-called advances to the company out of the proceeds of sale of the investments at the expense of the trade creditor of the company whose debt was first in time to that of the Director's advance if any as an act of misfeasance.

The question that is now posed is "Do these facts lead to any or strong presumption that the business of the company was carried out by the defendant with **intent to defraud** the creditors or for **fraudulent purpose** within the ambit of s. 304(l) of the Companies Act 1965; and if so on a finding of fact whether the Court would make a declaration to the effect that the defendant was knowingly a party to the carrying on of the business in the manner, to make the defendant personally liable (responsible), for all or any of the debts of the company? The basic question is how extensive an interpretation is to be given to the word **"fraud"**.

The term **"fraud"** has a distinctive meaning given in the *Concise Oxford Dictionary* - 9th Edn. as "the use of false representation to gain an unjust advantage; a dishonest artifice or trick; a person not fulfilling what is expected of him/her". "Fraudulent Purpose" - achieving by fraud; or dishonestly. Fraud and fraudulent purpose connotes actual dishonesty involving, according to current notions an unfair trading among commercial men, real moral blame in relation to the expected standard of an ordinary and honest people.

Maugham J has in *Re William C. Leitch Bros. Ltd.* [1932] 2 Ch. p. 71; has chosen to give a very liberal construction. The facts of that case were:

> L was a governing Director of the company and held a debenture on the company's property. The company got into financial difficulty and as such could not pay its creditor 6500 pound for goods supplied. L then proceeded to order further goods to the value of 6000 pound and which goods became the subject to the charge under his debenture. He then; as a chargee appointed a receiver and appointed himself as a manager. He collected the debts and removed the goods towards the satisfaction of his debenture; and Maugham J there **held** that **"if a company continues to carry on business and to incur debts at a time when there is, to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference to be drawn that the company was carrying on business with intent to defraud"** and, there made a declaration that L was personally liable for 6000 pound.

The test of the facts before this Court show the conduct of the defendant as a Managing Director of the company deriving for himself an unfair advantage over that of a creditor to whom he was a bare trustee and owed to himself the last preference in priority over the surplus of the company's funds. His conduct in preferring himself in payment over the priority of trade debts by signing a cheque to himself constituted an intention to defraud; or at least a fraudulent preference – morally not acceptable by the commercial world – as it is a dishonest conduct –; an act of misfeasance for one's own purpose or benefit and that Court will not lend its hand or support in the act of such dishonesty.

In the case of *Royal Brunei Airlines Sdn. Bhd. v. Tan Kok Ming Philip* [1996] 2 CLJ p. 380 at p. 390, the word dishonesty has been defined to simply mean **not acting as an honest person** in the light of the circumstances and has been equated with conscious impropriety.

Lord Nicholls of Birkenhead at p. 391 at para. C said –

> However, the subjective characteristics of honesty do not mean that individuals are free to set for themselves their own standards of honesty in the particular circumstances. The standard of what constitutes honest conduct in not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. **If a person knowingly appropriates anothers property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour** (as in this case paying to himself the entire proceeds of sale of shares; in preference to his creditor whose money he used in speculation on a frolic of his own) ... Honest people do not intentionally deceive others to their advantage. Honest people do not knowingly take others' property. Honest people do not participate in a transaction if he knows it involves misapplication of those assets of the trust ...

The defendant herein used the plaintiff's money in share investments in his personal name. He took a risk which was clearly an unauthorised transaction; and a risk of this nature should be to his own account and to be made accountable to the company for the losses caused to the company's and the creditor's money. He had no right to risk the funds in speculation to the prejudice of the plaintiff's right; he is "**guilty of commercially unacceptable conduct** in the particular context involved". Acting in reckless disregard of others' right or possible rights can be a tell-tale sign of dishonesty.

In short; was the defendant fulfilling the role of "The Reasonable Expectations of an Honest Businessman?" Keeping in mind "that honesty is the best policy" the defendant was expected to live to the standards to be observed by honest businessmen and not of an **unconscionable conduct** contrary to good conscience. The law of equity and good conscience is to be the order to be adopted in such commercial transactions to make good the resulting loss to

an innocent person whose trust in the defendant has been betrayed by his misconduct. The defendant holding 199,999 shares out of 200,000 shares was the company; and the company was the defendant; and their state of mind is imputed to each other. This was not a case where the company's money was simply lost in the ordinary course of the business being poorly administered; but upon a wrong with no right to employ the company's money in the purchase of shares in his own name creating a loss; resulting in the company being unable to pay the plaintiffs; thus becoming insolvent. "It is the trite law that no one - having such duties to discharge, shall be allowed to enter into engagements in which he has; or can have, a personal interest conflicting; with the interest of those to whom he was bound to protect or answerable. So strict is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into" *Aberdeen Ry. Co. v. Blaikie Bros* [1854] 1 Macq. 461, 471.

The commercial relationship between the parties imported an implied undertaking by one to act in the best interest of the other; rather than to his own; and this justifies the law's intervention to make a declaration as sought and order:

(1) That the defendant do personally pay the plaintiff the balance sum due and owing under the judgment dated the 28 day of May 1992 obtained by the plaintiff against the company - (Ventura Industries Sdn. Bhd.) *vide* Kuala Lumpur High Court Suit No. D3-22-1033-91 in the sum of RM392,479.81 together with all interest thereon at the rate of eight per cent per annum calculated from 23 March 1993; until the date of full realisation by the plaintiff from the defendant herein; together with all costs payable by the defendant to the plaintiff on a solicitor and client basis.

Reported by Jasmesh Kaur